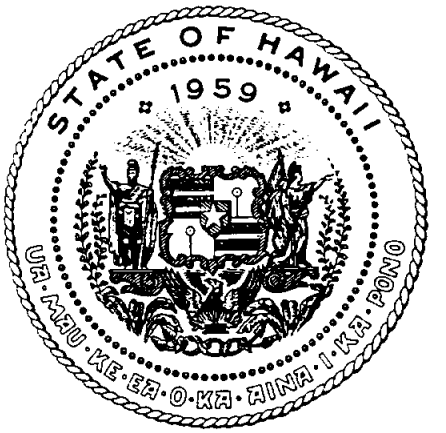

Informational Briefing Regarding The State of Hawaii's Workers' Compensation System

For the House Committee
on Labor and Public Employment
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Submitted by:
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I. Historical Background

The Hawaii Territorial Legislature adopted the state's first Workers' Compensation law in 1915. The Workers' Compensation Law was enacted to ensure that employees who were injured or disabled on the job were provided with medical treatment and fixed monetary awards (indemnity). This law was Hawaii's first "no-fault" legislation in that it mandated there be a presumption that an employee's injuries were "work-related", while prohibiting an employee from filing civil actions against the employer for work-related injuries or illnesses.

Under current Hawaii law, the employee sustaining a work-related injury or illness is entitled to medical treatment, wage loss benefits, permanent disability indemnity, disfigurement and death benefits. Any employer, including state and counties, employing one or more workers is required to provide workers' compensation coverage. Insurance premiums are paid entirely by the employer.

As such, Hawaii's workers' compensation system is a delicate balance of social and economic considerations. On one hand, injured workers have a legitimate right to expect prompt, quality medical treatment and be compensated when they are injured as a result of their employment. On the other hand, the cost of workers' compensation must be reasonable to the employer in order to ensure the stability of their business.

Yet, Hawaii's small business community has argued that Hawaii's current workers' compensation system is costly and ineffective. State statistics and employer experience has shown that it is taking too long to return injured workers back to meaningful employment, and Hawaii's employers are not paying affordable workers' compensation insurance premiums.

II. Recent Proposals to Reform Hawaii's Workers' Compensation System

A. In 2003, Hawaii Employers Paid the 3rd Highest Premiums for Workers' Compensation in the Nation

In 2003, a national study conducted by the State of Oregon ranked Hawaii 3rd highest in the nation in terms of dollars Hawaii employers pay for every $100 of payroll. In that study, it was identified that Hawaii employers paid $3.73 for every $100 paid in wages.

Additionally, in 2003, Pacific Business News and the Chamber of Commerce of Hawaii

polled Hawaii employers on what they considered to be their primary concerns. The cost of workers' compensation ranked as one of their primary concerns in both polls, especially for small employers who own and operate more than 90% of the businesses in Hawaii.

Further, in 2004, the Work Loss Data Institute gave Hawaii's Workers' Compensation System an "F" for the years 2001 and 2002. Hawaii received these failing grades due to:

a) High injury incidence rates;
b) 22.6 percent of injured workers stayed off the job for more than 30 days in 2002 - much longer than in other states (high number of lost days);
c) Longer return to work periods;
d) Lack of managed care options in the treatment of workers compensation injuries; and
e) High cost of workers' compensation insurance.

B. The Department of Labor and Industrial Relations ("DLIR") conducted an internal study of the workers' compensation system and provided recommendations

Since 2003, the DLIR has made reform to the workers' compensation system a priority and implemented changes using a three-pronged approach:

a) Identifying the cost drivers and areas for improvement;
b) Improving DLIR's internal operations; and
c) Recommending legislative proposals to reform Hawaii's Workers' Compensation Law.

The DLIR conducted an internal study and submitted to the 2004 Legislature a report identifying the cost drivers and recommending areas of improvement for Hawaii's workers' compensation system. The DLIR also submitted an omnibus workers' compensation reform package to the 2004 and 2005 Legislatures that addressed several key cost drivers identified by the internal study, while also ensuring that injured employees remain entitled to quality medical care and necessary benefits. Both omnibus bills were rejected in their entirety by the Legislature.

In January of 2005, the DLIR proposed significant changes to administrative rules pertaining to workers' compensation. The proposed changes focused on:

a) Improving the hearings process;
b) Instituting evidence-based medical treatment guidelines; and
c) reforming the state's vocational rehabilitation process.

The majority of the testimonies received regarding the medical treatment guidelines and hearings process were in favor of the proposals, while the majority of testimonies

received regarding the vocational rehabilitation proposals were opposed. Subsequently, the Governor approved the administrative rule changes to the hearings process and the administrative rules implementing medical treatment guidelines. The proposed changes regarding vocational rehabilitation were not implemented.

Improving the Hearings Process

The DLIR's administrative rules would have improved the hearings process by providing clear directives on the workers' compensation hearings process, including the discovery process, how and when hearings should be scheduled and the manner in which they should be conducted.

These basic hearings rules were meant to modernize the hearings process, bringing predictability, transparency, and accountability in a hearings system that is plagued with complaints of inefficiency, irregularities and soaring costs. This led to a hearings process that was unpredictable and gave the appearance of favoritism with regard to scheduling and conducting hearings. This change was needed because there are currently no administrative rules governing the hearings process.

The DLIR also amended the administrative rules to require that all hearings be recorded. The DLIR would have been able to periodically review the recordings to ensure that the parties receive a fair and impartial hearing, and that there is consistency in the DLIR's decisions. The DLIR felt that the interest of keeping the hearings process lax and "informal" must be balanced with keeping the process fair, equitable and efficient.

Most importantly, the administrative rules provided for an Alternative Dispute Resolution ("ADR") process. This would have allowed the parties to resolve their disputes through a private hearings officer, which would have lead to claims being resolved in a more timely and efficient manner. Similar forms of alternative resolution methods are being utilized throughout the state and have proven to be efficient and cost-effective in resolving claims outside of the workers' compensation system.

Instituting Evidence-based Medical Treatment Guidelines

In the administrative rules, the DLIR adopted the first seven chapters of the American College of Occupational and Environmental Medicine ("ACOEM") Practice Guidelines as the disability management philosophy for treatment in workers' compensation and adopted the Official Disability Guidelines Treatment in Workers' Comp, 3rd Edition.

The use of the evidence-based treatment guidelines was meant to ensure that injured workers receive the necessary quality medical care they are entitled to. Under the guidelines:

a) An injured worker could receive additional treatments or treatments not specified in the medical treatment guidelines if it is shown to be necessary and based on

evidence-based medical treatment;

b) An employer or its insurance carrier cannot deny treatment that is based on these guidelines;
c) In denying any treatment, the employer or its insurance carrier must disclose to the treating physician and employee the medically, evidence-based criteria used as the basis of the objection; and
d) Medical treatment guidelines will eliminate, or at least reduce delays caused by unnecessary disputes and litigation over treatment plans. It ensures that treatments are based on evidence-based medicine.

In providing an objective means, the DLIR recognized that our hearings officers, while highly trained professionals that take their jobs seriously, are not medical experts and yet are required to determine whether a contested medical treatment plan or IME report is correct or not. Prior to the new rules, the provider often had the presumption of correctness. (E.g., the findings of the medical provider are correct and the employer must overcome the presumption by a preponderance of medical evidence.)

However, after the administrative rules took effect, the 2005 Legislature nullified the administrative rules, returning the workers' compensation system to the status quo.

III. DLIR Implemented Internal Changes to improve the system

A. Streamlined the Workers' Compensation Hearing Process

Due to the nature of the hearings process that resulted in most claimants and employers waiting six to eight months for a hearing, the DLIR adopted an 80-day philosophy that requires hearings to be scheduled within 80-days of the receipt of the request for hearing. Additionally, because most cases settle the day before or the day of the hearing, the DLIR also implemented a hearings schedule similar to state court in which the DLIR would "double stack" hearings to allow for another hearing to be held if one or more scheduled hearings are settled. Further, the DLIR also began disallowing parties' requests for continuances, if the party is unable to show a compelling reason for a continuance. In the past, unnecessary continuances in a case resulted in unnecessary delays in the resolution of a claim.

These internal changes have resulted in faster claims resolution and allowed the DLIR to conduct over 2,500 hearings and issue over 10,000 decisions and settlements annually.

B. Ensured injured workers and employers receive a fair hearing.

In order to ensure that both injured workers and employers receive a fair hearing, the DLIR brought to Hawaii the National Judicial College to train all of our workers' compensation hearings officers. The course helped to improve the skills of our hearings officers in conducting fair, impartial and efficient hearings, and issuing clear and concise

decisions. The National Judicial College is the same institution that has trained many of Hawaii's appointed judges.

In addition to the training provided by the National Judicial College, the DLIR implemented a review process to ensure that decisions issued by the hearings officers are subject to review to ensure consistency and fairness. This ensures that the hearings officers are not advocates for the worker or employer, but advocates of the law and stewards of Hawaii's workers' compensation system.

IV. Initiated fundamental changes to the Hawaii Occupational Safety and Health ("HIOSH") branch

In addition to addressing the workers' compensation law and how the DLIR handles claims, the DLIR also implemented a change in the philosophy and culture of the HIOSH program. For years, the HIOSH had been accused by employers of being heavy-handed in its approach to enforcement. This in turn led to a mistrust of the HIOSH program and reluctance on the part of employers to ask for assistance in designing and implementing an effective safety and health program.

The DLIR made a concerted effort to take a consultative approach to safety and health with Hawaii employers and to shift from a "heavy-handed approach", to one that partners with the business and safety communities, which has been proven to be effective.

For the last 3 years, many of Hawaii's companies are forming partnerships with the HIOSH by enrolling in their achievement and recognition programs such as the Voluntary Protection Program ("VPP") and Safety and Health Achievement Recognition Program ("SHARP"). These programs are designed to recognize large and small companies that work with the HIOSH in creating and implementing an exemplary safety and health program. In 2002, there was only 1 VPP company and 0 SHARP companies. Today, after making a cultural shift that treats employers as partners and not adversaries, there are now 5 VPP companies and 35 SHARP companies.

This new philosophy has helped to reduce workplace injuries and workers' compensation claims despite an increase of over 60,000 new jobs to Hawaii's economy. As a result of our efforts to reform the HIOSH, there are fewer injuries, which have led to fewer claims:

a) In 2002, 29,752 claims were filed;
b) In 2003, 28,668 claims were filed (1,084 fewer claims, or 3.64% fewer workplace injuries); and
c) In 2004, 26,321 claims were filed (2,347 fewer claims, or 8.19% fewer workplace injuries.)

V. DLIR actions have shown results

The reduction in workers' compensation claims have helped to drop lost costs. Lost costs

are the amount of premium dollars spent on medical treatment and indemnity. Lost costs are a large component of what dictates the cost of the workers' compensation premium charged to employers.

The decline in injuries and claims, as well as the faster adjudication of controverted claims within the DLIR, helped Hawaii drop from being the third highest in the nation in 2002 for the cost of workers' compensation premiums, to fifteenth in 2006, in a national ranking compiled by the State of Oregon.

Additionally, employers insured through the Hawaii Employer Mutual Insurance Company ("HEMIC"), the state's largest workers' compensation carrier, have seen their premiums drop. In 2003, Hawaii businesses insured by HEMIC on average paid $5.36 for every $100 dollars of payroll for workers' compensation. In 2006, employers saw a decline of premium costs as those businesses are now paying, on average, $4.49 for every $100 of payroll.

Bob Dove, President and CEO of HEMIC, cited that the decrease in injuries and internal changes initiated by the DLIR are primary reasons for the decrease in premiums.

"This trend is a direct result of the decrease in injuries filed and the internal changes initiated by the Department of Labor and Industrial Relations," said Bob Dove, HEMIC president and CEO. "Many of those initiatives we have experienced are an improved administrative process, a level playing field when dealing with employees and employers, unbiased decision-making, and prompt hearings and resolution of claims that are heard at DLIR."

VI. Approved International Brotherhood of Electrical Workers' ("IBEW") and Electrical Contractors Association of Hawaii ("ECAH") Collectively Bargained Workers' Compensation Agreement ("CBWCA")

In early 2006, the IBEW and ECAH began a collective bargaining process to create an alternative workers' compensation system. Under Section 386-3.5, Hawaii Revised Statutes ("HRS"), private unions and their signatories are allowed to create their own workers' compensation system, so long as it does not provide less benefits than the law. However, it must be approved by the Director of Labor and Industrial Relations.

The attraction of this agreement to IBEW and ECAH contractors is that it helps ensure prompt, quality medical care for employees so they can return to work in a more timely manner, while likely reducing insurance premiums and other costs. Insurance carriers base workers' compensation premiums on an employer's payroll. ECAH's unionized contractors are likely to pay higher wages than their non-union counterparts and are therefore charged higher premiums, which can also place them at a competitive disadvantage, especially when bidding for public works projects.

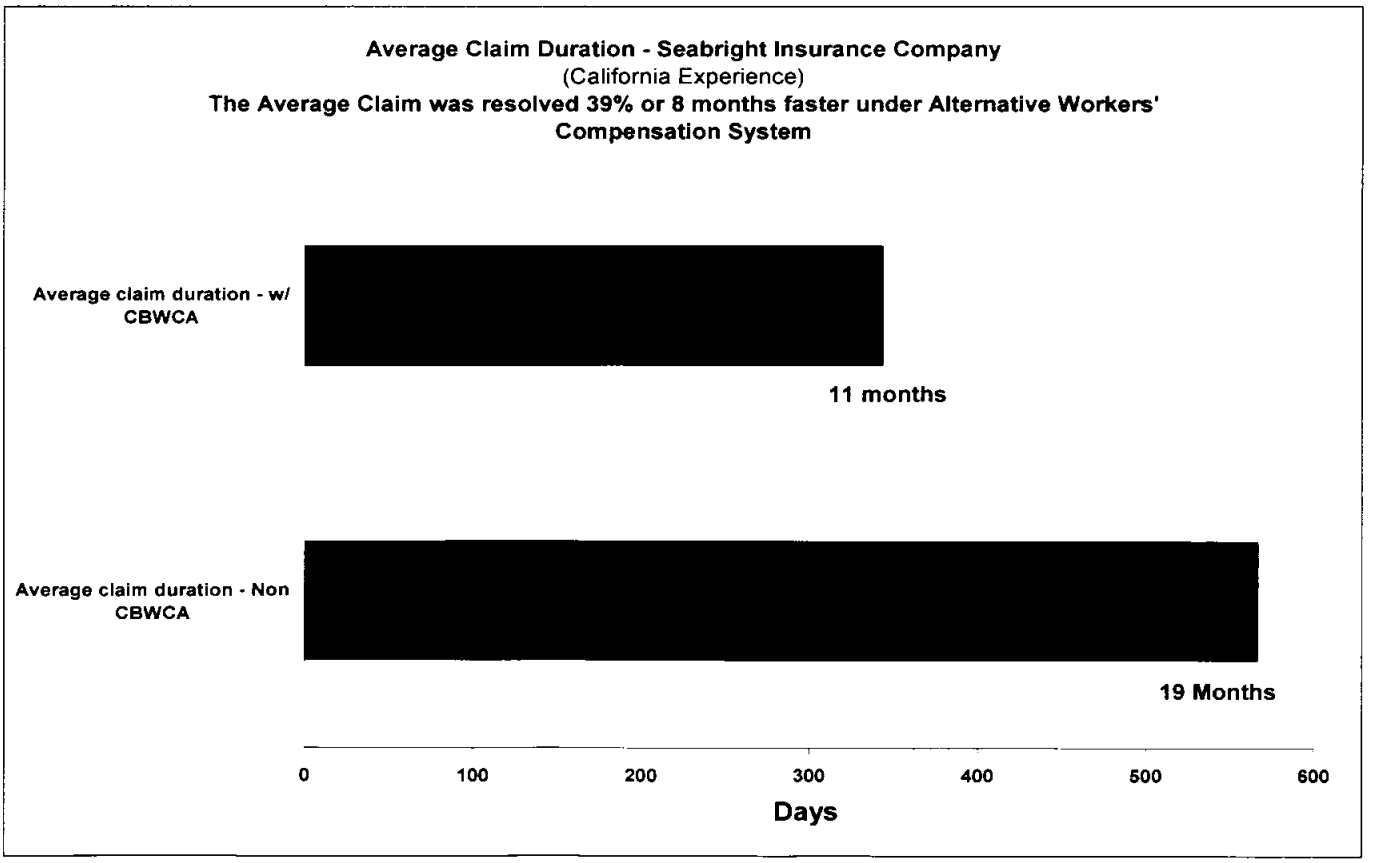
In September of 2006, the DLIR approved the Collectively Bargained Workers'

Compensation Agreement between the IBEW and ECAH. The agreement improves the Workers' Compensation system for employees and employers of the IBEW and ECAH by incorporating many concepts advocated for by the DLIR in the omnibus reform bills and the "nullified" administrative rules.

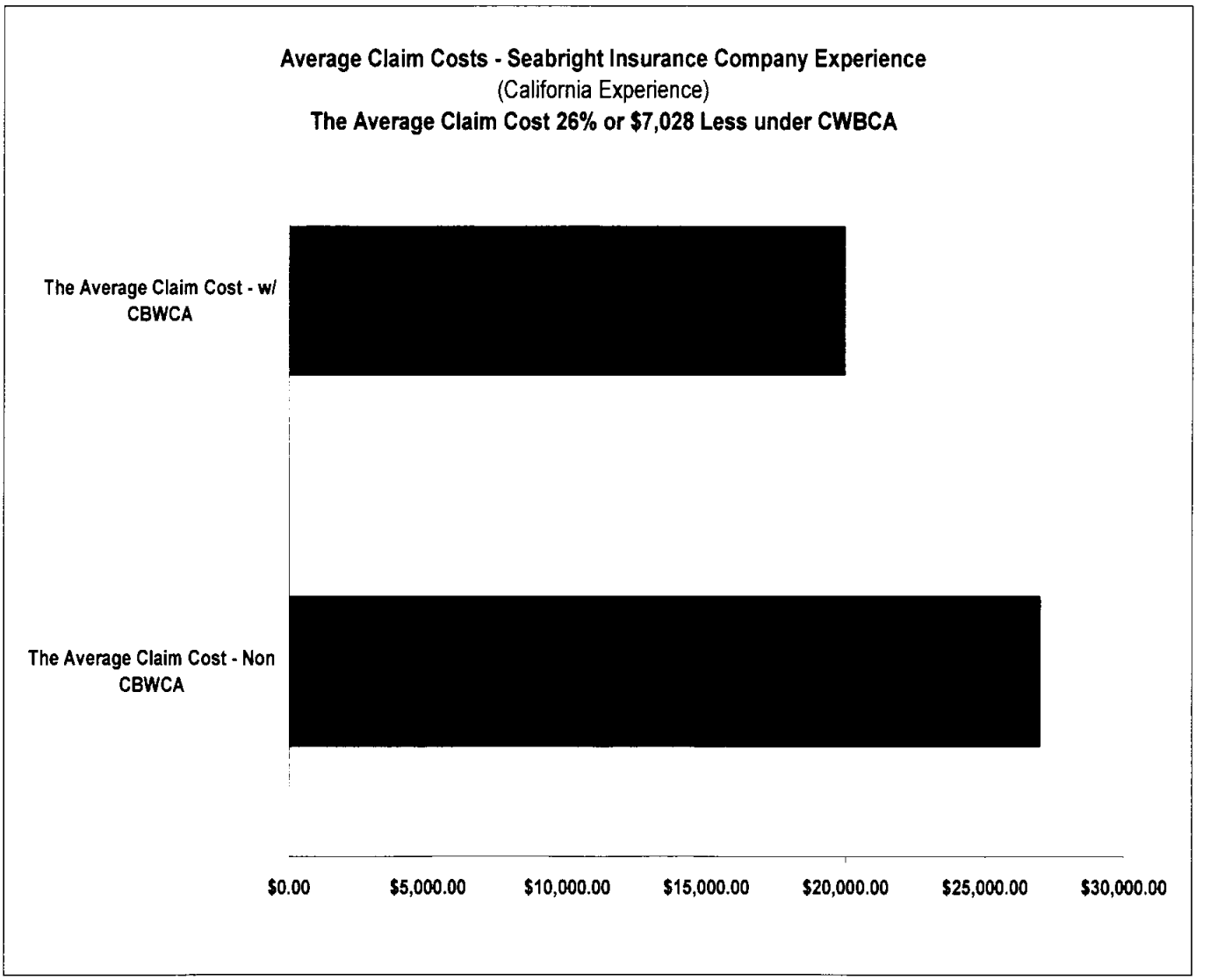
Those concepts include:

a) Creating and using a physician network of credible health care providers agreed upon by the IBEW and ECAH to provide prompt and quality medical care for employees so they can return to work faster;
b) Facilitating and expediting the claims process by utilizing alternative dispute resolution process;
c) Involving both the employers and employees in the decision-making process, thereby easing adversarial relationships; and
d) Utilizing the ODG Evidence-based treatment guidelines to ensure injured workers are provided with quality medical care based on medical evidence enabling timely return to work.

The CBWCA received success on the mainland with mainland unions and their signatory employers. As the following chart illustrates, the average claim duration, or amount of time it takes to close out an injured worker's claim, for a non-CBWCA was 566.3 days. Under the CBWCA, the unions and their signatory employers were able to reduce that time to 343.3 days. The CBWCA allowed claims to be resolved 39% faster.

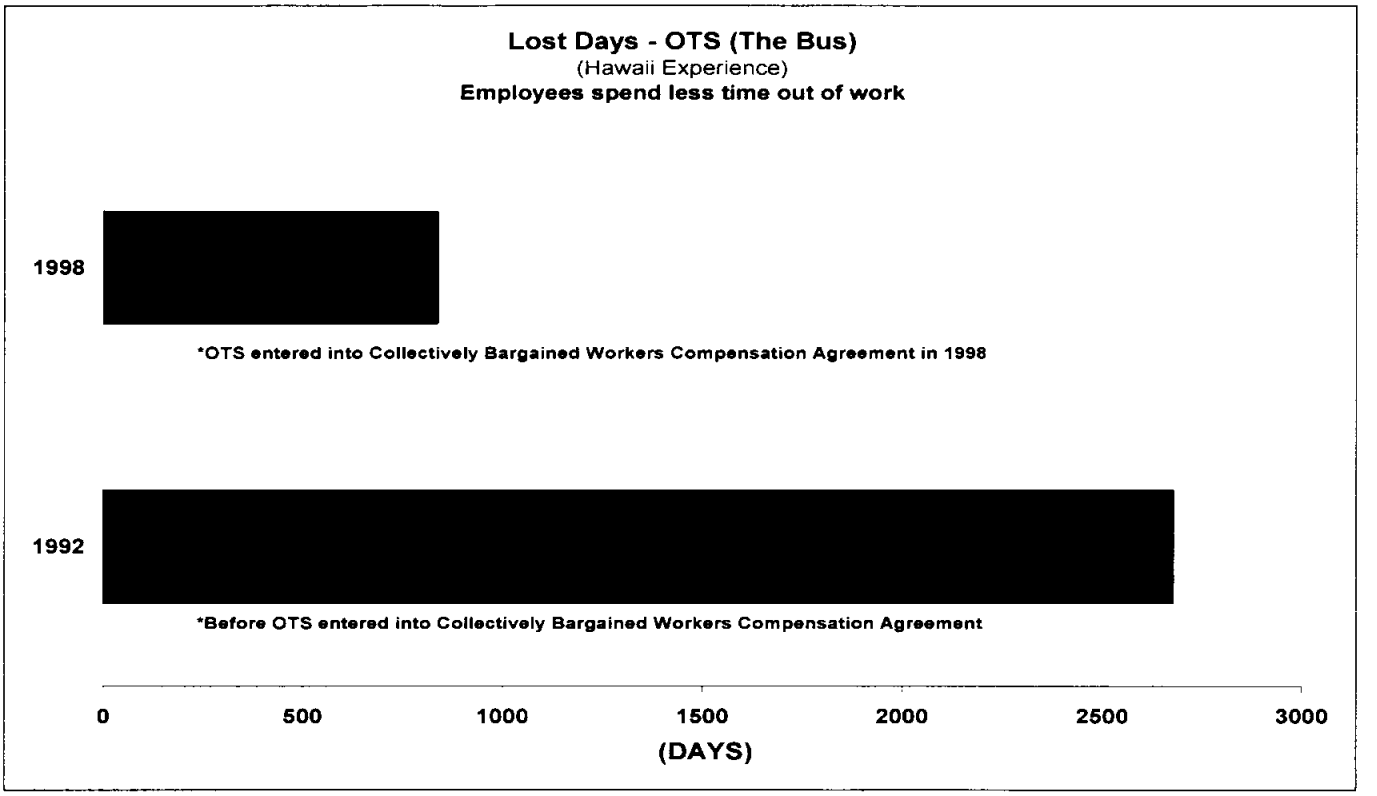


Additionally, the unions and their signatory employers were able to lower their workers' compensation costs, which directly affect premiums. For non-CBWCA, the average cost per workers' compensation claim was $26,966. Under the CBWCA, the average cost per claim dropped by 26% to $19,938.



In Hawaii, there is also local experience that helped to validate the CBWCA signed by the IBEW and ECAH. In 1998, the OTS system, or TheBUS, entered into a similar CBWCA. During that time, OTS was able to reduce the amount of lost days, or days in which an employee was not at work while out on a work injury.

Before the CBWCA, OTS lost days averaged 2,678. After implementing the agreement, OTS lost days declined to just 837.



Currently, the CBWCA covers 12 employers and over 784 employees. Employers include:

a) M. Watanabe Electrical Contractor, Inc.
b) AA Electric
c) RMH Electric Company, Inc.
d) D. Suehiro Electric, Inc
e) Wasa Electrical Services, Inc.
f) American Electric Company, LLC.
g) Electricians, Inc.
h) R. Electric, Inc.
i) A-1 A-Lectrician, Inc.
j) Grantco Pacific, Inc.
k) Electrician Hawaii, Inc.
l) HH Electric, Inc.

The DLIR is confident that this CBWCA will serve as a model for other unions, union contractors and state policy makers.

VII. New Initiatives Undertaken by the DLIR

The DLIR has also undertaken several initiatives to improve access to care and further expedite the resolution of claims currently before the DLIR, especially those claims regarding the interruption or denial of medical treatment.

A. Expedited Hearing Process for Medical Disputes

In early 2006, the DLIR initiated an expedited hearings process for medical treatment disputes. This initiative required that disputes regarding medical treatments deemed to be critical or emergency in nature were fast tracked to get a quicker resolution.

B. Raised Medical Fee Schedule to Ensure Adequate Compensation for Health Care Providers

Additionally, the DLIR also sought to provide relief to healthcare providers that have long complained that the reimbursement level was too low and causing providers to leave the system and not treat workers' injured on the job. Health care provider fees are statutorily based upon 110% of Medicare. The DLIR reviewed several thousand codes and eventually adjusted over 1,200 codes to ensure that health care providers receive fair fees for their service to our injured workers. The adjustments, which became effective January 1, 2007, provide:

a) An increase in Surgical codes by an average of 29.3% over 2005 Medicare Par plus 10%;
b) An increase in Medicine codes by an average of 4.2% over 2005 Medicare Par plus 10%;
c) An increase in Other Services by an average of 6.6% over 2005 Medicare Par plus 10%;
d) An increase in Evaluation and Management Services codes by an average of 20.7% over 2005 Medicare Par plus 10%.

C. Improved medical reporting Forms

Further, the DLIR also formed a working group which includes physicians (medical doctors, chiropractors and psychiatrists), insurance carriers, and claimant attorneys to assist in developing better medical reporting forms. This collaborative effort is focused on developing a form which provides essential and understandable information to all parties for both physical and psychological conditions. The report is also being expanded to incorporate treatment plan information that will inform all parties of the current status of the injured worker and the effectiveness of the treatments being provided. This new form is intended to reduce the "hassle factor" that many medical providers have long pointed to as a disincentive to treating employees

injured on the job.

D. Provide Objective Standards in Determining Attorney Fees

Further, the DLIR developed a system that incorporates objective standards in determining attorney fees, by establishing a clear guideline. The new criteria for a point based system are:

a) Years practicing as an attorney;
b) Knowledge of the workers' compensation law; and
c) Organization, presentation and representation skills.

Prior to this initiative, there were no clear standards on how to set attorney fees, leaving the DLIR open to criticism that attorney fees were based upon who you know and not what you know.

E. On-Line Filing of Workers' Compensation Forms

Finally, the DLIR has also focused on improving our services by initiating several On-line Initiatives. Currently, the DLIR is able to receive WC-1 forms (initial workers' compensation claim reports) from insurance carriers electronically through magnetic tape or disk. The DLIR hopes to improve upon this by designing and implementing an on-line electronic filing system of all workers' compensation forms, as well as cost and insurance coverage reports from insurance carriers and medical reports from health care providers.

The creation of this system will allow the DLIR to move toward creating an on-line system that allows claimants and employers to track claims and management reports in real time. This will greatly improve the efficiency of the system as well as to provide greater transparency and information to employees and employers regarding the status of their claims.

VIII. Considerations for State Policy Makers

A. Lack of Available Quality Physicians

As suggested earlier, anecdotal evidence exists that suggests a lack of physicians wanting to treat workers' compensation patients. It should be noted that this is especially true on the neighbor islands and in rural areas of the state where, in general, all medical providers, not just workers' compensation providers, are leaving to practice elsewhere.

A recent article published in the Pacific Business News highlighted the amount of medical doctors leaving the Big Island for Oahu and the mainland. Their common issues centered around the cost of living, cost of operating a business and the reimbursement levels from commercial carriers. These factors did not allow medical doctors operating in the rural parts of the state to operate their practices in an economically successful manner.

B. Providing Effective Oversight for Over-Treatment

Further, as policy makers discuss how to reduce the "hassle factor" for medical providers, they must strike a balance between reducing the "hassle factor" and ensuring the medical safety of the injured employee from over-utilization of unnecessary medical treatments. This balance must also recognize the needs of employers in assuring that the medical treatments they are paying for are necessary.

C. Recent Supreme Court Decision

Finally, the DLIR wishes to update this committee on a recent Hawaii Supreme Court decision that affects the successful prosecution and conviction of persons committing workers' compensation fraud.

In Tauese vs. State of Hawaii, DLIR., a claimant injured his back, buttocks and left knee while working as a housekeeper for the Ritz-Carlton on Maui. The Claimant was released from work and went to see his physician. He reported a pain severity of 5 on a scale of 1 to 10. He was later released to return to work the next day with a lifting restriction of no greater than 20 pounds and no bending.

On the day of the doctor's visit, the Claimant was under surveillance and videotaped skinning and cutting the carcass of a cow for about 1 hour. His activities included bending, cutting meat from the carcass, bagging the meat, and moving the bagged meat to the back of a truck.

However, in subsequent visits to health care providers, the Claimant continued to complain of pain and an inability to sit or stand for very long or play tennis or go hunting. A medical doctor who examined the Claimant and later saw the videotape opined that the Claimant had given a "purposely-factitious presentation." At a hearing before the Disability Compensation Division ("DCD") on the issue of permanent disability, the Claimant maintained that he was still very sore, could no longer play tennis or go hunting and had difficulty squatting and bending.

When asked about his ability to clean an animal after hunting, the Claimant responded in the negative, but said "...he can try". The Director issued a decision, awarding temporary total and partial disability benefits and disfigurement.

Thereafter, Ritz-Carlton filed a complaint for fraud against the Claimant pursuant to section 386-98, HRS. It requested the following relief: criminal penalties and/or fine and/or suspension or termination of benefits and/or reimbursement of benefits paid, and attorney's fees and costs.

The Claimant denied violating section 386-98, HRS, asserting that the application of criminal penalties was unconstitutional and the DLIR had no jurisdiction over criminal matters. A hearing was then held on the fraud complaint.

In the meantime, The Claimant also filed a complaint in the circuit court seeking declaratory and

injunctive relief prohibiting a hearing on the fraud complaint, on the grounds that a hearing as to administrative and criminal fraud would constitute double jeopardy and violated the state constitution.

Before any proceeding occurred in the circuit court, the Director issued his decision, finding that the Claimant violated section 386-98, HRS, and imposed a fine, suspending benefits, and required the reimbursement of Ritz-Carlton's attorney fees and costs. The Claimant appealed the decision to the Labor and Industrial Relations Appeals Board ("LIRAB").

The court case was thereafter dismissed and an appeal was taken to the Supreme Court regarding the dismissal. The administrative fraud case proceeded to conclusion, with the LIRAB issuing a decision affirming the Director's decision. The Claimant appealed that decision to the Supreme Court.

The two cases were consolidated by the Supreme Court and it issued an opinion. Although there were many sub-issues discussed by the Court, the main points are as follows:

The Court rejected Claimant's constitutional challenges to section 386-98, HRS. In addition, the Court upheld the imposition of the $5,000 fine and concluded that the administrative fine was not criminal and punitive. On the issue of the standard of proof required in the administrative hearing, the Court ruled that a violation of section 386-98, HRS, must be proved by clear and convincing evidence, rejecting the argument that section 91-10, HRS, which provides for a preponderance of the evidence burden of proof, applied. Because the LIRAB erred in applying the preponderance of the evidence standard of proof, the Court remanded the case to LIRAB for a rehearing based on the burden of clear and convincing evidence.

The DLIR notes this case because the Supreme Court has interpreted the standard of proof in successfully prosecuting and convicting persons who commit workers' compensation fraud to be "clear and convincing" as opposed to a "preponderance of the evidence". This interpretation may make it harder for the DLIR to combat workers' compensation fraud committed by employers, employees, and health care providers.